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SUBJECT: MACEDONIA'S MISSED CAPITAL INVESTMENT OPPORTUNITIES

#### SUMMARY

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11. (SBU) The GOM repeatedly has been unable to spend all the money it has allocated for capital expenditures, even though government infrastructure investments are a critical driver of sorely needed economic growth and employment. Analysis of the budgeting process indicates that balky procurement regulations, constant budget adjustments due to poor financial planning, and bureaucratic inefficiency are to blame for the government's lower-than-projected spending. End summary.

#### MORE SPENDING!

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12. (SBU) For several years, the GOM consistently has missed its capital expenditures targets, including spending for construction and rehabilitation of government facilities, roads, education and cultural facilities, and infrastructure for energy and utilities. Although targeted capital investments are important drivers of economic growth, the GOM again failed to maximize its capital investment expenditures in 2007. Although the GOM agreed with the IMF to a deficit target of one percent of GDP for FY 2007, according to Ministry of Finance (MOF) officials, it ended with a 0.6% surplus due to higher-than-expected revenues and laggard spending. Post developed this analysis of the reasons for the spending shortfall after discussions with MOF officials, the IMF Resident Representative, and such budget users as the GOM Road Fund.

#### ESTABLISHING CAPITAL EXPENDITURE TARGETS

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13. (U) The GOM's process for establishing budget targets, including capital expenditures, is relatively sophisticated largely due to an on-going Department of the Treasury technical assistance program. The budgeting process starts in March, with the development of the government's strategic priorities for the following year. Using these priorities, the MOF's budget department develops a medium term plan establishing spending ceilings for each budget user, such as the Ministry of Transport. After the Prime Minister and his cabinet approve the plan in May, a budget circular is prepared and sent to each user. Budget users, in collaboration with MOF, outline proposed capital projects for the fiscal year. Once initial GOM approval is granted, each user submits the completed circular to the MOF online. The circulars are combined into a draft budget in August; readjustments are then negotiated with budget users. The final draft is sent in November for Parliamentary approval, after which budget users may draw on allocated funds beginning in January of the new fiscal year.

## IF YOU HAVE IT, SPEND IT

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14. (SBU) Despite the collaborative nature of the budgeting process, many budget users consistently fall short of their proposed capital expenditures. These shortfalls are caused by a combination of procedural delays and hindrances in the procurement process, constant adjustment of the budget due to poor financial planning, and bureaucratic inefficiencies which hinder the planning and execution of capital projects.

## LENGTHY PROCUREMENT PROCESS

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15. (SBU) Procedural roadblocks inherent in the previous law on public procurement are the factors most often cited as reasons for shortfalls in capital spending. That procurement law included an unnecessarily long 60-day period for evaluating tenders. Each winning bid required MOF budget department approval after completion of the tender to ensure that funds were actually available. In addition, the appeals process was poorly managed and overwhelmed the commission assigned to review contested awards. These factors combined to retard procurement spending and lengthen the tender decision process. By law, unspent funds were returned to the National Bank at the end of the fiscal year. That required budget users to request new funds for the following year, and hampered execution of multi-phase/multi-year projects. The new law on public procurement, which became effective on January 1, reduces the deadline for deciding on tenders and removes the requirement for final bid approval from the MOF, which should help selected budget users execute capital spending plans with greater timeliness and efficiency.

## CONSTANT BUDGET READJUSTMENT

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16. (SBU) The GOM's habit of constantly readjusting the budget further complicates the procurement process. During the year, the GOM usually sends to Parliament at least one "rebalanced" budget with new spending targets. This adjustment process consumes administrative capacity and delays proposed tenders for capital projects until the rebalanced budget is accepted. In FY 2007, the GOM rebalanced the budget twice. While significantly greater-than-expected government revenues in FY 2007 triggered the first rebalancing, the second budget adjustment was implemented late in the fiscal year, leaving little time for new capital projects to be planned and executed. Improved forecasting during the initial budget formulation process would reduce the need for such adjustments during the fiscal year.

## BUREAUCRATIC INEFFICIENCY

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17. (SBU) A third factor contributing to missed capital spending targets is bureaucratic inefficiency among individual budget users. Authority within ministries is highly centralized, with the minister required to approve all projects. Procurement staff will not take initiative on proposed projects without executive guidance or approval, which contributes to delays. Slow and unrealistic implementation planning further complicates the process. Many budget users are aware in November of their likely funding allocations for the following fiscal year, but they do not begin to plan implementation of capital expenditures until after the budget actually passes the Parliament at the end of December. Finally, fund disbursements are based upon annualized schedules, not realistic analysis of the procurement schedule. The new procurement law permits 50 percent of unspent funds to be carried-over to the following fiscal year.

## IF YOU BUILD IT...

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18. (U) Despite obstacles inherent in the procurement process and bureaucratic decision-making cycle, some budget users do/do manage to meet their annual spending targets. For example, the Road Fund achieved 110 percent of its FY 2007 targets, proving that realistic capital spending targets can be reached. The Road Fund admittedly

benefits from a highly focused mission, but it is likely that other budget users could achieve similar results if executive attention and administrative resources were properly coordinated. The changes required under the new procurement law will assist in identifying other roadblocks in the capital expenditure process.

#### FISCAL CREATIVITY IMPROVED 2007 STATISTICS

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¶9. (SBU) In late 2007, the GOM used a creative but short-term solution to meet its capital spending targets. By the end of November, the GOM had spent only 65 percent of the amount budgeted for annual capital spending; by the end of December, however, the GOM miraculously had reached 98 percent execution of its capital spending target. The GOM achieved this apparent turnaround by quickly proposing new capital projects and transferring money to municipalities or independent government agencies to implement those projects. This allowed the GOM to disburse FY 2007 funds before the end of the year, while municipalities or independent agencies were given the opportunity to actually spend the money in the next calendar year.

#### COMMENT

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¶10. (SBU) Macedonia's public infrastructure needs significant investment, so it is unfortunate that the GOM has been unable to make full use of its available funds. While the spending shortfalls have been consistent over the past several years, the new procurement procedures should ameliorate one of the causes of low capital spending. However, the new procurement law will not address other obstacles to effective capital spending, including constant budget adjustments and bureaucratic inefficiency. Until those issues are resolved, the GOM is likely to continue using legal, but questionable, end-of-year transfers to municipalities and other government agencies to ensure capital spending targets are met. End comment.  
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